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## Effect of Leverage, Employee Stock Ownership Program and Managerial Ownership in Profit Management Practice

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### Abstract

This study aims to influence leverage, employee ownership programs and managerial companies based on the Indonesia Stock Exchange (IDX). The population in this study are all manufacturing companies listed on the Indonesia Stock Exchange from 2015 to 2017. The sampling method uses non probability sampling with a purposive sampling technique, the number of samples is 23 companies. Data analysis techniques using multiple linear regression analysis with earnings management as the dependent variable, while the independent variables in this study are leverage, employee stock ownership programs and managerial pensions. The results of this study indicate that leverage has a positive effect on earnings management practices, employee stock ownership programs on earnings management and negative workers.

**Keywords:** earnings management; leverage; employee stock ownership programs and managerial pensions.

### 1. Introduction

Financial statements are made with the aim of providing information or reports on the company's progress made by the management of the company to account for its performance. Financial statements also aim to provide information about financial positions and jobs to companies that are useful for users in economic decision making (Paradise) [1]. Financial statements are communication media that are used for parties with an interest in the company and also to account for what is done by the resource manager (Prastiti) [2].

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Spiders to measure company performance (Siallagan and colleagues) [3]. Therefore, management often conducts financial reports that are well presented by earnings management. Management that is realized in generating profits, will be beneficial for opportunist profits (Mahiswari and colleagues) [4]. This opportunist action is carried out by choosing certain accounting policies so that the company's profits can be regulated and manipulated raised or lowered according to their wishes, this action is known as earnings management (Boediono) [5]. Earnings management is a condition where management intervenes in the process of preparing financial statements for external parties so that it can flatten, raise, and decrease profits (Schipper) [6]. Earnings management is defined as the efforts of company managers to intervene or influence information in financial statements with the aim of tricking stakeholders who want to know the performance and financial conditions (Sulistyanto, 2008) [7].

Earnings management actions led to accounting reporting scandals in the business world, including Enron, Merck, World Com and other companies in the United States (Cornett and colleagues) [8]. The same thing happened in Indonesia, namely at PT. Indofarma. In this case, it began with a review of Bapepam regarding allegations of violations of laws and regulations in the capital market sector, especially related to the presentation of financial statements carried out by PT. Indofarma. (detik.com, edition November 8, 2004) [9]. Agency theory describes a relationship that occurs between the owner (principal) and the other party, namely the agent (Paramitha) [10]. The relationship between principal and agent can lead to conditions of information imbalance because agents have a position that has more information about the company than the principal (Verawati and colleagues) [11]. With the information gap between management and company owners, management has the opportunity to maximize their interests, one of which is by doing earnings management (Fauziah) [12].

Earnings management is the cause of the reduced credibility of financial statements because it can add to the bias of financial statements that might interfere with the user in trusting the engineering figures. If a condition where management does not succeed in achieving the specified profit target, management will utilize the flexibility allowed by accounting standards in preparing financial statements to modify reported earnings. Management is motivated to show good performance in generating maximum value or profit for the company so that management tends to choose and apply accounting methods that can provide better earnings information (Lindrianasari and colleagues) [13].

Leverage ratio is a ratio found in financial statements that can find out how much the company is financed by debt with the ability of the company described by capital, or can also show some parts of assets used to guarantee debt (Nugroho) [14]. Leverage has a relationship with the practice of earnings management, where investors will see the smallest company leverage ratio because the leverage ratio affects the impact of the risk that occurs. So the smaller the leverage ratio the smaller the risk, and vice versa. In this way when a company has a high leverage ratio, the company tends to practice earnings management because the company is threatened not to fulfill its obligations by paying its debt on time. The debt borrowed can be efficient and effective if the company can improve its performance so that its turnover will be normal (Subhan) [15].

Previous research states that leverage has a positive effect on earnings management as in Agustia [16],

Yamadita [17] and Wardani and colleagues [18] which states that leverage has a relationship with earnings management practices, investors will see the smallest company leverage ratio, because small company leverage ratio or the smaller the capital financed by debt, the company has a small risk too, and vice versa. While the results of research from Indriani [19], Jao [20], Subhan [15], Nugroho [14] show different results, namely, leverage has a negative and not significant effect on earnings management.

Employee Stock Ownership Program (ESOP) is a company share ownership program for employees that is expected to increase the sense of belonging so as to support the improvement of company performance. ESOP is a program that gives employees the right to share ownership. This is expected to get a positive signal (good news) from investors. (Herdianata) [21]. According to BEPEPAM [22], one of the objectives of implementing the ESOP is to create alignment of interests and mission of employees, executive officers with the interests and mission of shareholders, so that there is no conflict of interest between shareholders and parties running the company's business activities. The adoption of an equity-based compensation program such as ESOP appears as the best tool that encourages managers to make decisions that maximize company value. The research conducted by Anisa [23], namely the application of equity-based compensation programs such as ESOP, emerged as the best means of encouraging managers to make decisions that maximize company value.

Managerial ownership is one of the important factors in the occurrence of earnings management practices. Share ownership by management can avoid the possibility of information gaps regarding the condition of the company displayed by the agent (manager) so that the problem of misalignment of interests between owners / shareholders and managers can be overcome. Siallagan and colleagues [3] state that large shareholdings in terms of economic value have incentives to monitor. The alignment of information reception and full access to the information needed will minimize the occurrence of profit engineering carried out by management because managers who act as shareholders can exercise more intensive control than other stakeholders outside the company (external parties) Warfield and colleagues [24]. Managerial ownership has a negative relationship with earnings management. The results of this study support the evidence that managerial ownership reduces the opportunistic drive of managers so that it will reduce earnings management. So the greater the number of shares owned by management, the smaller the tendency of managers to do earnings management. Jensen and colleagues [25] state that there are parallels between the interests of managers and shareholders when managers have large numbers of company shares.

Based on this background, the researcher was interested in conducting research with the title "The Effect of Leverage, Employee Stock Ownership Program and Managerial Ownership on Profit Management Practices of Manufacturing Companies Listed on the Indonesia Stock Exchange".

## **2. Theoretical review**

**Agency Theory.** Agency theory can be seen as a contractual model between two or more people (parties), where one party is called an agent and the other party is called a principal. Principals delegate responsibility for decision making to agents, this can also be said that principals give a mandate to agents to carry out certain tasks in accordance with an agreed work contract. The authority and responsibility of agents and principals are

regulated in work contracts with mutual agreement (Jensen and colleagues) [25].

**Positive Accounting Theory.** Positive accounting theory is concerned with predicting such actions as the proposed accounting standards (Scott) [26].

**Profit management.** Earnings management is an attempt by managers to influence information in financial statements with the aim of tricking stakeholders who want to know the performance and conditions of the company (Sulistiyanto) [7].

**Pattern in Profit Management.** According to Scott [26] there are four patterns or activities in conducting earnings management, namely: Bath taking, income minimization, income maximization, income smoothing.

**Leverage.** Leverage, also known as solvability, is a ratio used to measure the extent to which a company's assets are financed by debt (Sartono) [27]. This ratio looks at how far the company is financed by debt or loans from outside parties with the ability of the company that is described by capital (equity). A good company should have a composition of capital that is greater than debt.

**Employee Stock Ownership Program.** ESOP is a kind of employee benefit program, which is almost the same in some ways with a profit sharing program. ESOP is held to achieve several objectives to give rewards (rewards) to all employees, directors and certain parties for their contribution to the increasing performance of the company.

**Managerial ownership.** Managerial ownership is the ownership of the company by management. Managerial ownership will align the interests between management and shareholders. The greater the proportion of managerial ownership in the company, the more effective management will be to meet the interests of shareholders who are themselves (Jensen and colleagues) [25].

### **3. Research Hypothesis**

Based on the framework, the hypothesis proposed in this study as follows:

H<sub>1</sub>:Leverage has a positive effect on earnings management practices.

H<sub>2</sub>:Employee Stock Ownership Program has a negative effect on earnings management practices.

H<sub>3</sub>:Managerial ownership has a negative effect on earnings management practices.

### **4. Research methods**

This research was conducted on manufacturing companies listed on the Indonesia Stock Exchange (IDX) by accessing the IDX website, [www.idx.co.id](http://www.idx.co.id) [28] and through the Indonesian Capital Market Directory (ICMD) in 2015 to 2017. The reason researchers chose research location in manufacturing companies because manufacturing companies are companies that sell their products starting with an uninterrupted production

process starting from purchasing raw materials, processing the materials to being products that are ready for sale. Where this is done by the company itself, it requires a source of funds to be used in the company's fixed assets. Manufacturing companies need more sources of long-term funds to finance the operations of their companies, one of which is by investing in shares by investors.

Sampling using nonprobability sampling method is purposive sampling with the criteria used, namely: (1) Registered companies including manufacturing companies that have gone public on the Stock Exchange during the period 2015-2017, (2) Companies that have complete financial statements about earnings management variables, leverage, employee stock program ownership and managerial ownership in 2015-2017, (3) Manufacturing companies that experience losses every year. (4) Financial statements are issued in rupiah. The dependent variable in this study is leverage, employee stock ownership program and managerial ownership. The independent variable in this study is earnings management. Data analysis method used is multiple linear regression analysis.

## **5. Result and discussions**

The analytical tool used to test  $H_1$  is a method of multiple regression analysis because regression analysis is used to examine the effect of independent variables on the dependent variable and indicate the direction of the relationship of these variables. Based on the discussion of theory, research data, research variables, and previous research, the form of multiple regression equations of this study uses the following models:

$$Y = \alpha + \beta_1.X_1 + \beta_2.X_2 + \beta_3.X_3 + \varepsilon$$

Information:

$Y$  = Profit Management

$\alpha$  = constant value

$\beta_1, \beta_2, \beta_3$  = Regression coefficient of independent variables

$X_1$  = leverage ( $X_1$ )

$X_2$  = employee stock ownership program ( $X_2$ )

$X_3$  = managerial ownership ( $X_3$ )

$\varepsilon$  = standard error

The results of the regression analysis are described in **table 1** as follows:

**Table 1: Multiple Linear Regression Analysis**

Coefficients <sup>a</sup>								
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	.041	.011		3.633	.001		
	X1	.059	.007	.650	8.955	.000	.998	1.002
	X2	-.049	.022	-.165	-2.203	.031	.936	1.068
	X3	-.313	.053	-.446	-5.953	.000	.937	1.067

a. Dependent Variable: Y

Source: Secondary data, 2018

Based on Table 1 the regression equation of the results is as follows:

$$Y = 0.041 + 0.059X1 - 0.049X2 - 0.313X3$$

The regression equation can be described as follows:

- 1) The constant value  $\alpha$  is 0.041 which means that if the variables leverage, ESOP and managerial ownership are considered constant (fixed or no change), then earnings management practices are 0.041.
- 2)  $\beta_1$  coefficient value of 0.059 means that if the value of the leverage variable increases by one unit then the practice of earnings management increases by 0.059 assuming variable leverage remains constant.
- 3)  $\beta_2$  coefficient value of -0.049 means that if the employee stock ownership program increases by one percent, the earnings management practice decreases by 0.049 assuming the variable employee stock ownership program remains constant.
- 4)  $\beta_3$  coefficient value of -0.313 means that if managerial ownership increases by one percent then earnings management practices decrease by 0.313 assuming managerial ownership variables remain constant.

### Influence of Leverage on Profit Management Practices

The results of the t test statistic show that the leverage variable has an unstandardized value of beta coefficient of 0.059 with a significant level of 0.000 less than 0.050 where H1 is accepted which means that the leverage variable has a positive effect on earnings management practices. Leverage has a relationship with earnings management practices, when a company has a high leverage ratio, the company tends to practice earnings management because the company is threatened not to fulfill its obligations by paying its debts on time. This is explained in the agency theory, the closer the company is to violating accounting-based debt agreements, the more likely it is for company managers to choose accounting procedures that move reported earnings from future periods to the current period, this is done because net income reported increases reduce the likelihood of failing to repay debts in the future (Watts and colleagues) [29].

### **Effect of Employee Stock Ownership Programs on Profit Management Practices**

The results of the t test statistic show that the variable Employee Stock Ownership Program has an unstandardized value of beta coefficient of -0.049 with a significance level of 0.031 less than 0.050 which means H2 is accepted. This means that the employee stock ownership program variable has a negative effect on earnings management practices. The greater the ESOP program implemented by the company, the tendency to make earnings management actions in a company will decrease.

### **Effect of Managerial Ownership on Profit Management Practices**

The results of the t test statistic show that the earnings management ownership variable has an unstandardized value beta coefficient of -0.313 with a significant level of 0.000 less than 0.050 which means that H3 is accepted. This means that negative managerial ownership variables influence earnings management practices. The greater the shares owned by management, the smaller the probability of earnings management actions carried out by managers because management in the company is also the owner of the company so there is no information asymmetry between management and company owners.

## **6. Conclusion and recommendation**

- (1) Leverage has a positive effect on the earnings management practices of manufacturing companies listed on the Indonesia Stock Exchange from 2015 to 2017. This shows that the higher the leverage the higher the opportunities managers have to practice earnings management.
- (2) Employee Stock Ownership Program negatively influences the earnings management practices of manufacturing companies listed on the Indonesia Stock Exchange from 2015 to 2017. This shows that ESOP can create alignment of interests and mission of employees with the interests and mission of shareholders, so that there is no conflict of interest between shareholders and parties running the company's business activities. Thus the actions of employees will decrease in earnings management because it will bear the good and bad consequences of actions taken.
- (3) Managerial ownership has a negative effect on earnings management practices of manufacturing companies listed on the Stock Exchange in 2015 to 2017. These results indicate that an increase in the percentage of shares held by management can reduce earnings management actions.

Based on the conclusions described, some suggestions can be given as follows:

- (1) In this study leverage variables have a positive effect, ESOP has a negative effect and managerial ownership variables have a negative effect on earnings management practices. Therefore, it is recommended that the owner or majority shareholder of a company to participate in managing and becoming part of the company's management so that there is no information imbalance between owners and management of the company so as to reduce the occurrence of earnings management practices within the company.

- (2) Further research can involve other independent variables to see which variables give influence to earnings management, for example other mechanisms in good corporate governance besides managerial ownership.
- (3) Further research can be carried out by using samples from other company categories besides manufacturing companies to prove whether the conclusions obtained in this study apply to all types of industries or not.
- (4) Further research can add to the number of years of observation so that the level of generalization will be higher.

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